Grafton Group Limited

Annual Report
For The Year Ended
January 31, 1978

ONE HUNDRED & TWENTY-FIFTH · ANNIVERSARY ·

Contents

HEAD OFFICE
9 Sunlight Park Road, Toronto, M4M 3G1 (416) 461-9411

ANNUAL MEETING
The Annual Meeting of Shareholders will be held at 11:00 a.m., May 11, 1978 in Toronto in the Ontario Room, Royal York Hotel, 100 Front Street West.

	Year Ended January 31,			% Change	
				1978 over 1977	1978 over 1976
	1978	1977	1976		
	Omitting 000's				
TOTAL SALES	**$169,683**	**$154,988**	**$139,248**	**+ 9.5**	**+ 21.9**
Comprised of:					
Retail Division					
Stores	**36,456**	32,177	28,771	+ 13.3	+ 26.7
Licensed Woolco Departments	**86,460**	79,762	69,971	+ 8.4	+ 23.6
Total Apparel	**122,916**	111,939	98,742	+ 9.8	+ 24.5
Footwear	**34,165**	31,553	29,359	+ 8.3	+ 16.4
	157,081	143,492	128,101	+ 9.5	+ 22.6
Homefurnishings Division	**12,602**	11,496	11,147	+ 9.6	+ 13.1
Income from operations before depreciation, interest and amortization	**22,965**	19,935	19,726	+ 15.2	+ 16.4
Income from investments	**916**	580	611	+ 57.9	+ 49.9
Depreciation and interest	**3,491**	3,317	3,140	+ 5.2	+ 11.2
Inventory tax credit	**391**				
Income before income taxes	**20,227**	17,056	17,055	+ 18.6	+ 18.6
INCOME BEFORE EXTRAORDINARY ITEM	**11,012**	**8,869**	**8,531**	**+ 24.2**	**+ 29.1**
NET INCOME FOR YEAR	**11,258**	**8,869**	**8,531**	**+ 26.9**	**+ 32.0**
*Earnings per common share before extraordinary item					
Basic	**3.83**	3.12	3.01	+ 22.8	+ 27.2
Fully Diluted	**3.58**	**2.93**	**2.81**	**+ 22.2**	**+ 27.4**
Inventory tax credit per share	**.13**				
*Dividends paid per common share (current annual rate $.76)	**.67**	.473	.40	+ 41.6	+ 67.5
Working capital	**42,869**	25,002	19,848	+ 71.5	+ 116.0
Shareholders' equity	**43,643**	33,891	26,281	+ 28.8	+ 66.1
Average number of shares outstanding	**2,874,354**	2,843,128	2,838,390		
Shareholders' equity per share	**15.18**	11.91	9.25	+ 27.5	+ 64.1
Percentage of net income to sales	**6.63**	5.72	6.13		
Effective tax rate percentage	**45.1**	47.4	49.4		
Current ratio	**3.3:1**	2.5:1	2.1:1		
Earnings as a percentage of shareholders' equity	**25.8**	26.2	32.4		
Dividends as a percentage of net income	**17.1**	15.2	13.3		

*Prices, Profits and Dividends are restrained from October 14, 1975 by the Anti-Inflation Act.

In May of 1853 the first Grafton Store was opened in Dundas, Ontario, by James Beatty Grafton, about the time of the commencement of construction of the railways into southwestern Ontario. Six more stores were opened in the territory by 1910. By 1961 only three more stores were opened and the Company had sales of about $3,000,000.

In 1912 the first Maher Shoe Store opened in Toronto under the name Reliance Shoe.

In 1926 the first Jack Fraser Store was opened in Toronto by Jack Fraser, and quickly established an image of providing superior value to the consumer. Management of the chain, which had been expanded into the Toronto suburbs after the War in the early community plazas, remained in the Fraser family until 1960.

In 1962 the first Woolco Store opened with Jack Fraser Stores appointed as licensee for the Boys' and Men's Wear department.

How did these enterprises come together?

The contemporary history of the Company commenced in November of 1961 when G. R. Chater and W. A. Heaslip acquired the controlling interest in Grafton & Co. Limited from Stewart Philp, a Director of the present company. Shortly thereafter, G. A. Reynolds was recruited from the Company's present auditors to head up the financial and accounting side of the team.

In 1964 a group including four of the present Directors, Messrs. Gilbride, James, McCutcheon and Weldon purchased A. Bradshaw and Son (1882) Ltd., which included the Jack Fraser Stores.

The President of A. E. Ames, the late W. B. Macdonald, introduced the Bradshaw and Grafton parties, and ultimately they merged in 1967 to form Grafton-Fraser Limited. Combined assets were redirected into those areas that would be most productive, and unprofitable divisions were phased out. All of these redeployed financial assets were committed to the Woolco expansion program that was then moving into high gear. The new group was able to achieve a consolidated profit of $187,000 in calendar year 1967, a turnaround from a loss in the previous year. The Company has been successful in increasing its earnings in each year since the merger.

Due to a large loss carry-forward in a discontinued drapery subsidiary of Bradshaw's, Grafton Group decided to enter the home furnishings industry through the purchase in 1969 of Toby Industries Limited, which had a long history of profitable operations. Similarly it was concluded that the Company was sufficiently profitable to embark on the gradual but accelerated expansion of the Jack Fraser Stores in 1970, after three years of consolidation, while continuing its participation in the growth of Woolco. The Company has continued to grow internally in parallel to the rapid expansion of Woolco, which has become Canada's largest department store chain in terms of square footage, and the growth of Jack Fraser to a national chain. Highlights of this expansion program are:

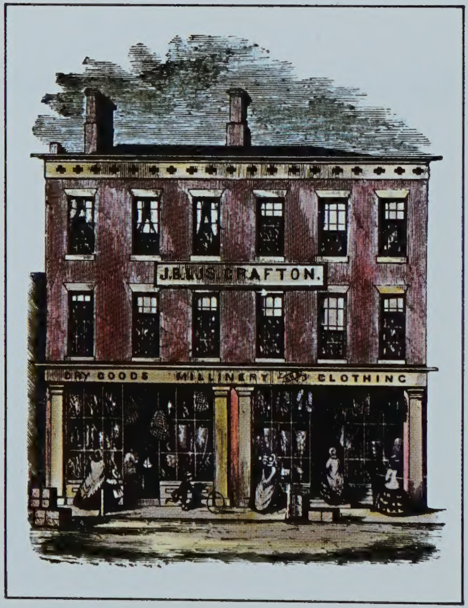
Calendar Year

1967 The formation of Grafton-Fraser Limited

1969 The acquisition of Toby Industries Limited

1971 The successful issue of common shares to the public at $10.75 per share (which have since been split 3 for 2) and listings on the Toronto and Montreal Stock Exchanges

The first Grafton store opened May, 1853.



Fashions, circa 1910.

1971 The acquisition of Grafton Realty Company, Limited which completed the purchase of Head Office property at 9 Sunlight Park Road, Toronto, from Lever Bros. Limited in 1972
1973 Purchase of 33⅓% interest in Forsyth Trading Company Limited
1974 Acquisition of assets of James B. McGregor on behalf of Toby Industries Limited
1974 Purchase of 99% of the common shares of Maher Shoes Limited
1975 Sale of short term commercial paper to finance seasonal inventories
1977 Purchase of 50% interest in George Richards Kingsize Clothes Limited
1977 Sale of $15 Million 20-year unsecured sinking fund debentures (the first public issue of long term debt securities)

The Future

Since 1967 the Company has expanded rapidly on a modest capital base, but always in a responsible manner to its lenders, banks, trade creditors and shareholders. It was able to do so by achieving a high return on its capital and by an ability to forecast accurately the future cash flows on which its leverage could be safely structured. We now have a solid rising earnings base and an adequate liquidity which provides the opportunity of expanding more rapidly than ever before.

We have a strong, experienced and dedicated management team, seasoned by successfully dealing with the most competitive marketing conditions known to contemporary Canadians since the Second World War. We have an ancient past, a proud tradition, a vigorous present and a promising future. In the beginning, the guiding merchandise philosophy of the Founders was fashion, quality, value and service. And so it continues.

Today fashions at Jack Fraser.

Last year we were surprised to win one of eleven Financial Post awards for our annual report, which was judged to be the best in the merchandising section. This year we have expanded our report further than has been our custom, due to celebrating our 125th year.

In the year most recently ended, your Company returned to a more traditional improvement in earnings after a disappointing performance the previous year due to our adjustment to the AIB regulations. Sales were up 9.5% to $169,683,000 compared with $154,958,000. Net income before the gain on sale of investments was up 24.2% to $11,012,000, compared with $8,869,000. This was equal to $3.58 per share fully diluted, as compared with $2.93, after giving effect to the 3 for 2 share split approved at the Annual Meeting held on April 28, 1977. The share split was recommended in an effort to increase the liquidity and marketability of the Company's shares on behalf of all shareholders, and appears to have worked satisfactorily.

We are particularly gratified to report that every subsidiary of the Company achieved all time record sales and earnings. As anticipated in this report a year ago, the first quarter started off poorly, but comparative results improved as the year unfolded and our last quarter gained momentum at Christmas time, producing outstanding results for that period and a satisfactory year.

Dividends were increased on June 15th to 18¢ per split share, and December 15th to 19¢ per share, the maximum allowable under the AIB regulations until October 14, 1978. The Company made capital expenditures of $2,782,000, and purchased a 50% interest in George Richards Kingsize Clothes Ltd. in April for $2,808,000. In June we successfully marketed an issue of $15,000,000 20-year unsecured sinking fund debentures. Our cash and near cash assets amounted to $27,461,000 at year end and exceeded all outstanding long term debt. 98% of our shareholders' equity is represented by working capital and our working capital is very liquid. We are in a strong position to develop new initiatives, while nourishing and improving the growth of our existing activities.

The reasons for issuing the long term debt were: the Company's credit rating was revised upward, the investment climate was favourable, the future availability of funds in uncertain economic and political environments was unclear, and the Company felt any future acquisition or investment could best be dealt with from a strong cash balance sheet.

We are actively surveying possibilities in the United States and a number of our senior people are engaged in this project. We have found ourselves to be at a substantial disadvantage to competing American acquirers due to a number of reasons. Our Company is not well known there. Some owner-vendors require a three year payout to spread the cost of capital gains, and some American lawyers seem unfamiliar with the value of Canadian obligations and jurisdictions. Nevertheless our people have gained a great deal of experience and maturity in measuring the value and marketing approach of a number of diverse concerns. We are optimistic of success in participating eventually in this market.

As the AIB draws to a close, we view Federal and Provincial deficits as alarming, and the reduction in value of our currency and national wealth is the dramatic result. The irresponsibility of governments in managing the affairs entrusted to them has resulted in many people and corporations regarding the United States as a more desirable home for future investments, and this is a great inhibitor to confidence and renewed growth in Canada, badly needed for the young people now entering the labour force.

We expect the economic and competitive environment in the forthcoming year to be similar to the one just passed, but due to greater productivity from our existing stores we expect an improved sales performance for our Company. This opinion is also based on the fact that consumers, according to our most recent three months' operating results, are more optimistic about their circumstances than the prevailing opinion of the business community.

This is the 125th year of the existence of the Grafton Group of companies, and while the expectations for the performance of the economy as a whole are deeply disappointing as compared with the capability of the Canadian people, the short term prospects for large specialized retailers is probably better than many alternative investments in this country at this time.

We acknowledge the loyal and continuing support of our employees, associates and suppliers who have contributed, through the years, to this remarkable record of survival and success over this 125-year timespan in Canadian history.

On behalf of the Board of Directors

G. R. Chater
President
March 21, 1978

The Company is concerned with the decline of public and investor esteem for business in general. This is due to many recent disclosures, more particularly in the United States but also in respect to some Canadian companies, including Crown Corporations. These disclosures involve unfunded liabilities, bribes, kick-backs, conflicts of interest and embezzlement. We are confident that all senior management of our Company have and will continue to conduct themselves in an ethical manner, but we also feel that the introduction of a formal code of ethical behaviour will serve the Company at this time.

Conflict of Interest

The Company is presently instituting a formal conflict of interest policy covering all areas of concern in respect to the conduct of directors, officers and senior employees.

FACTS RELATING TO UNDISCLOSED OR UNRECORDED LIABILITIES

Store Opening Expenses

All expenses relating to store openings are expensed in the year in which the store is opened.

Pensions

The Company has no liability in respect to past or current service benefits.

Capitalization of Leases

The capitalized asset value of all leases using actual commencement dates and terms is $31,073,000 at the end of the year. This calculation has been made using a 10% interest factor. If the leases had been capitalized, this method of accounting would have the effect of recording depreciation and interest in lieu of minimum rental payments and would reduce the net income by approximately $340,000 or 11¢ per share for the year.

Current Value Accounting

Based on current replacement costs and using our present depreciation rates, the estimated net book value of our leasehold improvements and fixtures is approximately $700,000 in excess of the net book value recorded in the accounts. The extra charge to income, after tax, would be approximately $30,000 or 1¢ per share. The value of the lands and buildings on a replacement cost basis owned by Grafton Realty Company, Limited and Maher Shoes Limited has not been taken into account in the calculations and no adjustment has been made for other assets or liabilities due to their current nature.

Foreign Exchange Exposure

In both of the retail companies, about 20% of all merchandise purchased is denominated in U.S. dollars.

In our manufacturing company, about 50% of purchases of raw material is denominated in U.S. dollars. It has been our practice during past years to hedge these purchases by the purchase of future U.S. dollars. At the present time, the Company is not hedged.

CORPORATE GOALS IN RESPECT TO EARNINGS AND DIVIDENDS

Earnings

The Company aspires to achieve an average annual compound growth of fully diluted earnings per share of 15% or greater in an environment of average inflation of 6% or less and a viable economic climate.

Dividends

The Company, which now has access to the long term debt market, believes a payout ratio of between 25% and 30% of the previous year's earnings on all classes of shares (if there were more than one class of share) is appropriate for the near term.

OWNERSHIP OF THE COMPANY

Greywinds Investments Limited, of which G. R. Chater, W. P. Gilbride, W. A. Heaslip and G. A. Reynolds are shareholders, together with J. W. McCutcheon and his associates, own 49% of the common shares of Grafton Group Limited.

T. E. Topping
President, Grafton-Fraser Limited.
Born in 1923, Mr. Topping joined the R.C.A.F. from high school where he became a pilot and served overseas. After demobilization in 1946, he joined A. Bradshaw and Son, Limited, also working when possible for Jack Fraser. In 1960, A. Bradshaw purchased Jack Fraser Stores Limited. Mr. Topping was appointed Vice-President and General Manager, Jack Fraser Stores Limited in 1963. After the merger of Grafton's and Jack Fraser Stores in 1967, he became a Director and Vice-President of Grafton-Fraser Limited and a Director of Grafton Group Limited. In 1971 he was elected President of Grafton-Fraser Limited, a position which he continues to hold.

Business of the Company
Grafton-Fraser is one of the three largest retailers of Men's and Boys' Wear in Canada. Our Jack Fraser Stores division commenced in 1926 with one store in Toronto and has been expanded into every province to consist of a total of 89 stores.

Our Woolco division commenced in 1962 with one store in Windsor, Ontario, and has been expanded across the country to consist of a total of 93 outlets.

In 1977 Canadian retailers experienced continued difficulties, partly due to adjusting to changing AIB guidelines. Competition was keen and sales increases were achieved mainly at the cost of reduced margins and special promotions. For the second year in a row increased productivity per square foot in terms of unit sales was greater than the corresponding increase in dollar sales per square foot. The consumer has benefitted greatly from this intense competition.

Favourable and better planning resulted in little or no carryover of Summer or Winter merchandise.

Because our merchandisers achieved a better balance in their inventory mix than in the previous year, we were able to capitalize on the December surge in sales. Increased volume during the heavy traffic months resulted in lower inventories and reduced markdowns. The success of the merchandisers was equalled by the operations team in controlling expenses despite the extensive increases confronting them from all sources.

Restriction of imports is interfering with long established delivery patterns. As a result the consumer pays more on items that in many cases could not be and are not made in Canada. Closer liaison between the regulating bureaucrats and the distributors and merchandisers is a vital requirement in the public interest.

Regional shopping centre locations are becoming more scarce and future internal growth will be somewhat less rapid than during the past ten years. We, fortunately, have several provinces and many growth areas still available to us. The Woolco expansion will now include medium-sized cities, smaller stores and lower square footage in various departments. The experience we have gained in operating departments in four converted Woolworth Stores will be beneficial in the future.

While reasonable growth for Jack Fraser is possible from new shopping centre developments, one of the major trends in the shopping centre industry is the modernization and renovation of existing centres. Generally speaking such programs allow for the expansion of specialty tenants such as Jack Fraser. These opportunities arise for a number of reasons. Leases of independents mature in centres in areas of Canada in which Jack Fraser did not operate previously, and Jack Fraser is a desirable addition to the developers who are national and know us well. Other independents fail or just retire from business. In some cases it is the expansion of the shopping centre that creates the opportunity. Today, 67% of Jack Fraser sales are coming from Ontario and if we achieve balanced sales across the country in, say, eight years, we will have doubled the number of our locations.

Last year in this report we made a commitment to increase inventory turnover, and this was in fact achieved. We have expanded our Buying and Supervisory staff and thus improved the flow of sales and stock information. This, in turn, is giving us better inventory control, faster turnover of stock and reducing stock-outs dramatically. Procuring personnel to support our expansion program is a never ending challenge. We know that reliable well-trained staff will increase sales, but despite the high rate of current unemployment, it is possible that young people, better educated than ever before, may have been led to believe by the educators that they could enter the work force at a higher level than what the practicalities of business will permit.

Grafton-Fraser's lengthy success has been based on these cornerstones of retailing–Fashion, Quality, Good Value and Service, and we are extremely optimistic that 1978 will produce another significant year of growth in both sales volume and increased earnings.

Co-ordinated Casuals in the Woolco Mens Wear Department.

A. L. Lucas, *Senior Vice President*
Born in 1935, Mr. Lucas commenced working for the company after school at the age of 12. He joined the Company on a full-time basis in 1952 and worked as a clothing salesman and store manager until 1965 when he was appointed Supervisor and Display Manager of Jack Fraser Stores. In 1967, he became Assistant General Manager–Stores.

In 1971, he transferred to the Leased Department Division as Vice President with overall responsibility for the operation of the Woolco Men's & Boys' Wear Departments. In 1975, he was promoted to Senior Vice President–Leased Departments, the position he now holds.

Business of the Division
Grafton-Fraser operates a leased department in every Woolco Store in Canada and Woolco is the largest Department Store Chain in Canada in terms of retail square footage. Grafton-Fraser occupies between 9 and 10% of the selling footage for the sale of men's and boys' wear. Departments range from 3,000 to 13,500 square feet and average 8,400 square feet.

This is the largest division of the Company in terms of gross revenues and financial commitment. Sales in 1968 were $10,085,000 or 47% of our total volume and now are $86,460,000 or 51% of the total.

Ninety-three Woolco Stores were in operation as of the year end. The 1977 Woolco expansion program included the conversion of four Woolworth Stores to Woolco Stores and these conversions have proven successful for Grafton-Fraser.

Five new Woolco Stores and the conversion of two Woolworth Stores are planned to open in 1978. Steady growth of Woolco sales is assured due to their present broad exposure in strategically located suburban trading areas, coast to coast.

Based upon the questions asked by financial analysts, the most difficult aspect of our business for them to understand is the relationship with Woolco. We believe that the two companies enjoy a classic business relationship involving mutual benefits. On January 10, 1978, F. W. Woolworth Co. Limited completed the sale of sinking fund debentures which was preceded by the issue of a public prospectus. Certain information that was private is now a matter of public record. We quote from the Woolworth prospectus: "When the Company started the Woolco Division it was decided that certain departments within the stores would be operated by licensees in order to gain the benefit of merchandising expertise not otherwise available within the company. Accordingly the Company entered into license arrangements with a number of specialized merchandisers. These departments accounted for 21% of the sales area and 29% of the aggregate sales of the Woolco division in the year ended January 31, 1977."

As a licensee, we pay rent to Woolco based on sales and space occupied. As our sales per square foot have increased over the years, the rent paid has increased proportionately. The rentals, as a percentage of sales, are high as related to normal rentals of the retailing industry and, therefore, require us to place great emphasis on efficiency. From the Woolworth prospectus it can be ascertained that Grafton is paying in excess of 50% of the rentals received by the Woolworth company from all sources.

Woolco was one of the first discount stores in 1962 and although a host of others entered the field, very few have survived. Woolco has prospered because of their able Canadian management team who have produced results which are superior to those of the other divisions of its American parent. Woolco forged ahead because it has successfully evolved into a full line department store while retaining the better aspects of its value image. Woolco has an exciting future in Canadian retailing and we look forward with pride in continued participation in their success based on past performance levels.

Sales increased less than 4% in the first half of 1977, followed by a 10.8% third quarter increase and a 12.4% improvement in the high volume fourth quarter for an 8.4% full year sales increase. This sales increase was modest in comparison to many recent years. However, profits increased satisfactorily in ratio to the sales increase due primarily to keen expense control and minimization of lost sales in the areas of basic and proven best selling merchandise.

The Grafton-Fraser merchandise assortment for Men and Boys, in Woolco, is directed to the needs of the average suburban shopper, providing large and complete selections of basic apparel at popular and competitive prices. Fashionable casual wear and active sportswear sales are increasing rapidly, in line with the steadily growing participation of the Canadian male in leisure lifestyle activities.

Regular world-wide monitoring of fashion trends, establishment of an internal Quality Control Department and ever-increasing buying power assure Woolco customers of current fashion interpretations in Men's and Boys' Wear, guaranteed as to quality and value.

J. B. Coutts, *Senior Vice President*
Born in 1924, Mr. Coutts served in the R.C.N.V.R. from 1943 to 1945. On his return to business life, he became a store manager with Maher Shoes Limited. During the years 1946-1966, he held the positions of Supervisor, Buyer and Vice President and in 1967 was appointed President and Director of Maher Shoes Limited, offices he held for four years.

In 1971, he joined the Grafton group of companies and was appointed Vice President–Stores for the Jack Fraser Division. He was promoted in 1974 to the office of Senior Vice President–Stores, a position he continues to hold.

Business of the Division

Jack Fraser operates 89 stores in all the Provinces of Canada. These stores sell men's apparel including suits, furnishings and sportswear aimed to appeal to style and value conscious men. 70% of the stores have a Loft Department consisting of 20% of the square footage of the store, carrying junior ladies sportswear of medium price aimed at the fashion conscious young lady. 10% of the stores have a separate "Jacks" shop, selling jeans, tops and bottoms and other separates.

Typical store sizes range from 4,000 to 5,000 square feet.

The Stores Division enjoyed its 11th consecutive year of both increased sales and earnings. Sales in the latter half of the year were strong and confirmed the growing consumer awareness of our value and service.

Sales increased 11% in the first half of 1977 followed by a 15% increase in the fourth quarter which, of course, includes Christmas. During the year, 4 stores were closed and 13 new stores opened.

We are operating this Division with long term plans of accelerated growth, and our past year's performance reaffirms our confidence in the directions we have planned. Our substantial investment in both store upgrading and system controls has been well justified and will be further reflected in future years' profits when our present program is completed. Fashion is the most important aspect of our business, and a clearly defined goal of our market position has been extremely helpful in attaining our objectives.

We continue to emphasize a strong Quality image with our customers. Our objective is acknowledged to be a constant and continuing program of close alliance with our suppliers and staff to maintain strict quality controls. Value is the cornerstone on which our business is built, and our ability to offer consistent value is clearly reflected in our past years' sales.

It is our responsibility to oversee the diverse operation of the stores, the Loft departments and now the Company's interest in the George Richards Kingsize Stores through mutual cooperation and agreed standards. Within the last few years, we have achieved a rate of return on sales which we believe would be amongst the most respected in our industry in North America.

In summary, we expect that the coming year will show continued growth in the quality of our earnings through the dedicated efforts of all those involved in our Division.

From this season's sport shirt selection.

T. P. Wilson, *President*
Born in 1932, Mr. Wilson started his career with Maher as a part-time, after school sales clerk at the age of 14. In 1950, Mr. Wilson joined Maher on a full time basis and progressed through various managerial assignments until 1960 when he joined the head office team as a supervisor. He was elected a Director of Maher in 1962, appointed Vice President in 1967 and promoted to President in 1971, a position which he still retains.

Business of the Company
Maher operates 176 retail stores across the country. Its divisions consist of Maher, Bonita, Shoeman, Copp, J. Reid and leased departments. The various divisions cater to different types of customers and cover the medium and higher priced shoe range.

We are pleased to report that the Company's consolidated sales and profits in 1977 were the highest on record, as all retail divisions have shown increased sales and profits from last year.

While the retail market conditions throughout Canada during the year have tested the management strength of the Company, after a soft Spring, we enjoyed a record Fall and Winter selling season with a fourth quarter sales increase of 23.3%, and much of this impetus has continued into the current year. Along with this, continued improvement and efficiencies from a consolidation of the operating and merchandising functions has been achieved. This has been accomplished at a time when a number of small to medium sized competitors have ceased operations.

During the year, 15 new stores were added and 15 stores were closed, while 20 small adjacent divisional shopping centre stores were combined, ending the year with 176 total units in operation.

Although the footwear industry will be further challenged with short term supply vibrations, created from the government imposed import quotas, we remain optimistic and confident that our Company is soundly positioned to maximize its continued planned growth, due in part to long standing Canadian supplier relationships.

Our financial position has improved dramatically over the last few years, and the reduction of our financial expenses as a proportion of total expense has been one of the factors in our improving results. We are confident the current year will accomplish a new record in our earnings, given reasonably stable economic conditions.

Homefurnishings Division

T. R. Young, *President*
Born in 1920, Mr. Young joined Toby in 1939, starting in the shipping department. He worked in various other departments of the Company during the next 16 years and in 1955 was appointed General Manager. In 1960, he was elected President of Toby. After the acquisition of Toby by Grafton Group in 1969, Mr. Young became a Director of Grafton Group and continued on as President of Toby, a position which he still retains.

Business of the Company
The company is comprised of two divisions in separate plants in Toronto. The Toby Division manufactures bedspreads, comforters, cushions and other related home furnishing items, while the McGregor Division manufactures and imports shower curtains and a complete line of bathroom accessories. Our customers are the major department stores and chains as well as specialty stores across the country.

The past year has been most rewarding in the market acceptance of the new styles produced by Toby and James B. McGregor divisions. The response to the new Toby comforter line was very encouraging and was the major reason for the 10% increase in sales during a very difficult period.

The McGregor division experienced fairly grave difficulties in the last half of fiscal 1976 and the first half of 1977. These were due to a management reorganization at the time of installation of a complex computer program. However, the problems were overcome and the division returned to profitability in August of last year and has continued to perform well subsequently.

Contract negotiations for both divisions with the Amalgamated Clothing and Textile Workers Union will be instituted in 1978 and a continuation of the excellent relationship between the Union and the company are anticipated. While this is the only company in the group that is unionized and has been for some time, we have as yet never had a strike.

Our objective in 1978 is for increased penetration of the market for the new styles and fashions that have been developed while increasing the profitability of the company through tight budgetary restraints.

G. A. Reynolds, *Vice President, Finance*

BALANCE SHEET

Assets

Cash

Bank deposit receipts amount to $23,500,000 and the remaining balance in this account was mainly represented by cash in transit from stores.

Marketable Securities

The Company has made investments in shares of 4 listed public companies. Three of the investments are in preference shares with an after tax yield to the Company of approximately 7.8%. Since the year end, investments in 7 other listed companies at an approximate cost of $3,000,000 have been made in high quality, high yielding securities. The balance of the cash is being used internally to finance seasonal inventory increases and is invested in short term interest bearing securities. It is the Company's intention to maintain a relatively high liquid position while endeavouring to locate suitable long term investments or acquisitions.

Accounts Receivable

Trade accounts receivable of the manufacturing division, after provision for doubtful accounts, and amounts due for sales under licensee arrangements comprised most of this account. There were no advances or loans to officers or directors.

Inventories

Inventories rose by 4.9% compared with the sales increase of 9.5% and, as a result, the number of turns improved to 5.9 from 5.6.

Investments

Over the past 4 years the Company has made 3 investments in companies which are being carried in the accounts as equity investments. The total original investment in the companies was $4,059,000. The equity earnings to date from these investments are $2,139,000 and the book value as at January 31, 1978 was $5,865,000.

Forsyth Trading Company Limited – 33⅓% owned

Forsyth is a manufacturer of fine quality shirts, ties and pyjamas under the well known Forsyth and Pierre Cardin labels. Consumer acceptance of the high fashion, superior Pierre Cardin garments has been outstanding. In addition, good quality sweaters and knit shirts have been imported from better manufacturers in various parts of the world. A wholly owned subsidiary, Mylord Shirt, imports and manufactures a variety of men's furnishing items under the Fruit of the Loom and private brand labels. Sales for the Forsyth group of companies increased by 31% in 1974, 10% in 1975, 27% in 1976 and 31% in 1977. Of the original investment of $1,000,000 in preference shares made in late 1973, ⅓ were redeemed during the current year and it is Forsyth's intention to redeem the balance over the next two years.

George Richards Kingsize Clothes Limited – 50% owned

George Richards operates 12 men's clothing stores specializing in large size garments. Eleven of the stores are located in Ontario and one is in St. John's, Newfoundland where a large mail order business indicated a need for a specialty store of the Richards type. It is Richards' intention to expand into a national chain of specialty shops as expediently as possible. Suitable locations should become more readily available with the combined leasing strength of Grafton Group. Sales for 1977 increased by 23.8% over 1976.

Barcley-Lanes Shoes – 50% owned

Barcley-Lanes is a chain of eleven shoe stores located in regional shopping malls in Southern Ontario. The chain has been developed in conjunction with Savage Shoes (1970) Limited, a leading Canadian shoe manufacturer, and retails high fashion, branded lines of ladies' and men's footwear. Sales in 1977 for stores open at the beginning and end of the year rose by 10%.

Condensed, Consolidated Financial Statements of Equity Investments

BALANCE SHEET

	December 31, 1977	December 31, 1976
Current assets	$19,144,000	$15,355,000
Current liabilities	10,135,000	8,887,000
Working capital	9,009,000	6,468,000
Fixed assets, net	2,016,000	1,533,000
Other assets, net of liabilities	234,000	(5,000)
Net assets	$11,259,000	$ 7,996,000
Represented by		
Capital stock	$ 2,514,000	$ 3,567,000
Retained earnings	8,745,000	4,429,000
	$11,259,000	$ 7,996,000

STATEMENT OF INCOME

	Year Ended December 31, 1977	Year Ended December 31, 1976
Sales (after elimination of inter-company sales of $5,590,000 in 1977 and $3,907,000 in 1976)	$50,031,000	$33,035,000
Income before income taxes	4,518,000	2,602,000
Income taxes	1,879,000	1,119,000
Net income for the year	$ 2,639,000	$ 1,483,000

Grafton Group Limited's approximate interest in the above figures is as follows:

	1977 Amount	1977 %	1976 Amount	1976 %
Net income (after goodwill)	$ 777,000	29.4	$ 485,000	32.7
Book value	5,865,000		2,613,000	
Less unamortized goodwill	1,768,000			
Net asset value	$4,096,000	36.4	$2,613,000	32.8

BALANCE SHEET REVIEW *(Continued)*

Fixed Assets

The increase in fixed assets was mainly attributable to the opening of 28 stores and the refurbishing of several older units. After depreciation, the net cash outlay amounted to $1,054,000.

Liabilities

Accounts Payable

The increase resulted largely from receipt of merchandise later in the year and accruals for such items as percentage rent and commissions which were higher due to the level of sales through December.

Income and Other Taxes Payable

Instalment payments, as required by the Government, were increased through the year which resulted in a lower balance.

Long Term Debt

The increase in long term debt from $9,395,000 to $21,017,000 is due to the following:

Long term debt at beginning of year	–	$ 9,395,000
Debt issued	–	15,000,000
		24,395,000
Debt prepaid	–	3,378,000
		$21,017,000

Shareholders' Equity

Capital Stock

During the year 28,125 shares were issued under an Employee Stock Option Plan (which has expired) and 780 shares under terms of the 7¼% convertible debenture for an increase in the outstanding capital stock of 28,905 shares represented by $420,000.

Retained Earnings

The contributed surplus, because of its small amount, was reclassified as retained earnings during the year. The increase in retained earnings without the above-noted transfer was $9,332,000 or 35%.

STATEMENT OF INCOME

Cost of sales and expenses other than undernoted decreased from 78.5% to 77.8% while rental and license expense increased to 8.6% from 8.5% of sales. This resulted in an increase in the income from operations percentage to 13.5% from 12.9%.

Income from investments increased by 57.8% which was mainly attributable to the outstanding year of Forsyth Trading Company Limited.

Depreciation increased by $208,000 for the year as a result of our investment in new stores and other equipment. Total interest declined marginally.

As a result of these factors, the pre-tax income increased by 18.6% and was 11.9% of sales in 1978 compared with 11.0% in 1977.

The effective tax rate declined by 2.3% to 45.1% from 47.4%. Without the inventory tax credit, the effective tax rate would have been 47.0%.

The dividends paid during the year amounted to $1,926,000, an increase of 43.1% in dollars over those paid in the preceding year. As a percentage of income before extraordinary item, the dividends amounted to 17.5% compared with 15.2% for the preceding year.

SUBSIDIARIES

Grafton-Fraser Limited–100% owned

Sales for the year increased to $122,916,000 from $111,939,000 or 9.8%. Net income for the year amounts to $8,497,000 up from $7,029,000, an increase of 20.9%. Of the increase, $245,000 or 3.5% is attributable to the inventory tax credit. Inventories were $17,619,000 as compared to $16,909,000 last year and inventory turns improved to 7.0 from 6.6 turns.

Maher Shoes Limited–99.9% of common shares owned, 60¢ preference shares, 100.0% owned by the public and they are listed on The Toronto Stock Exchange.

Sales for the year were $34,165,000, an increase of 8.3% from $31,553,000 for the previous year. Since being acquired in 1974, sales have risen to the current figure, $34,165,000 from $27,440,000, an annualized increase of 7%. It should be noted that Maher has closed or combined 90 stores during this period which has had an adverse effect on sales growth and a short term dampening on profits. Net income for the year, after preference dividends, was $949,000, an increase of 43.1% from $663,000. Of this increase, $105,000 or 15.8% was due to the inventory tax credit. Inventory at the year end amounted to $7,725,000, $7,468,000 last year, and turns increased to 4.4 from 4.2.

Toby Industries Limited–100% owned

Sales for 1977 rose to $12,602,000 from $11,496,000 or 9.6%. Since the acquisition in 1969 sales have climbed to the present $12,602,000 from $4,115,000 for an annualized increase of 15%. The acquisition of James B. McGregor division has accounted for a substantial portion of the sales increase. Net income for the current year was $398,000 up by 81.7% from $219,000. The inventory tax credit was $41,000, representing 18.7% of the increase. Inventory was $3,585,000 compared to $3,208,000. Inventory turns for the respective years were 3.5 and 3.6.

Grafton Realty Company, Limited–100% owned

Grafton Realty Company, Limited has gross assets of $3,535,000 which are comprised of 9 acres of land in east central Toronto, where the corporate head offices and Toby manufacturing facilities as well as a modern office building and warehouse leased to Lever Brothers Limited are located, and various downtown locations in 5 southern Ontario communities. There are no encumbrances on any of the properties. Gross rentals, including rent to related companies, was $826,000 this year and $801,000 last year. The company's income contribution is nominal.

Summary of Financial Data by Corporate Division

	Sales–1978		Sales–1977	
	Amount	% of total	Amount	% of total
Grafton-Fraser Limited				
Stores	$ 36,456,000	21.5	$ 32,177,000	20.8
Licensed Woolco Departments	86,460,000	50.9	79,762,000	51.4
	122,916,000	72.4	111,939,000	72.2
Maher Shoes Limited	34,165,000	20.1	31,553,000	20.4
Toby Industries Limited	12,602,000	7.5	11,496,000	7.4
Total	$169,683,000	100.0	$154,988,000	100.0

	Assets–1978		Assets–1977	
	Amount	% of total	Amount	% of total
Grafton-Fraser Limited	$ 44,731,000	52.3	$ 34,990,000	56.1
Maher Shoes Limited	13,916,000	16.3	13,429,000	21.5
Toby Industries Limited	7,563,000	8.8	6,509,000	10.4
Grafton Realty Company, Limited	3,535,000	4.1	3,284,000	5.3
Grafton Group Limited (net of consolidation adjustments)	15,845,000	18.5	4,155,000	6.7
Total	$ 85,590,000	100.0	$ 62,367,000	100.0

	Net Income–1978		Net Income–1977	
	Amount	% of total	Amount	% of total
Grafton-Fraser Limited	$ 8,497,000	77.2	$ 7,029,000	79.3
Maher Shoes Limited	949,000	8.6	663,000	7.5
Toby Industries Limited	398,000	3.6	218,000	2.5
Grafton Realty Company, Limited	27,000	.2	11,000	.1
Grafton Group Limited (net of consolidation adjustments)	1,141,000	10.4	948,000	10.6
Total before extraordinary item	$ 11,012,000	100.0	$ 8,869,000	100.0

Consolidated Statements of Income and Retained Earnings

Grafton Group Limited

INCOME

	Year ended January 31, 1978	1977
Sales		
Retail	$157,081,000	$143,492,000
Manufacturing	12,602,000	11,496,000
	169,683,000	154,988,000
Cost of sales and expenses other than undernoted	132,074,000	121,903,000
Rental and license expense	14,644,000	13,150,000
	146,718,000	135,053,000
Income from operations before the following	22,965,000	19,935,000
Income from investments	916,000	580,000
Income before taking into account the undernoted items	23,881,000	20,515,000
Depreciation	1,728,000	1,516,000
Interest on long term debt	1,701,000	1,018,000
Other interest	83,000	783,000
Amortization of goodwill	142,000	142,000
	3,654,000	3,459,000
Income before income taxes, minority shareholders' interest and extraordinary item	20,227,000	17,056,000
Income taxes (note 9)	9,121,000	8,093,000
Income before minority shareholders' interest and extraordinary item	11,106,000	8,963,000
Preference share dividends paid to minority shareholders of Maher Shoes Limited	94,000	94,000
Income before extraordinary item	11,012,000	8,869,000
Gain on sale of listed marketable securities, net of income taxes of $54,000	246,000	
NET INCOME FOR THE YEAR	$ 11,258,000	$ 8,869,000
EARNINGS PER SHARE (note 6)		
Income before extraordinary item		
Basic	$3.83	$3.12
Fully diluted	3.58	2.93
Net income for the year		
Basic	$3.92	$3.12
Fully diluted	3.66	2.93

RETAINED EARNINGS

	1978	1977
BALANCE AT BEGINNING OF YEAR	$ 26,505,000	$ 18,982,000
Net income for the year	11,258,000	8,869,000
Contributed surplus transferred to retained earnings	156,000	
	37,919,000	27,851,000
Dividends on common shares	1,926,000	1,346,000
BALANCE AT END OF YEAR	$ 35,993,000	$ 26,505,000

Grafton Group Limited
(Incorporated under the laws of Ontario)

ASSETS	January 31, 1978	1977
CURRENT ASSETS		
Cash and bank deposit receipts	$25,209,000	$10,111,000
Marketable securities, at lower of cost and market (market value, $2,799,000)	2,251,000	
Accounts receivable	5,199,000	4,185,000
Inventories (note 2)	28,929,000	27,585,000
Deposits and prepaid expenses	265,000	313,000
	61,853,000	42,194,000
INVESTMENTS (note 3)	6,167,000	3,724,000
FIXED ASSETS, at cost		
Land	1,348,000	1,348,000
Buildings	3,065,000	3,025,000
Equipment, fixtures and leaseholds	16,336,000	14,739,000
	20,749,000	19,112,000
Less accumulated depreciation	8,702,000	7,952,000
	12,047,000	11,160,000
UNAMORTIZED FINANCING COSTS	376,000	
GOODWILL, less amortization	5,147,000	5,289,000
	$85,590,000	$62,367,000

Approved by the Board

JOHN B. RIDLEY, *Director*

G. R. CHATER, *Director and President*

LIABILITIES	January 31, 1978	1977
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	**$15,866,000**	$11,209,000
Income and other taxes payable	**3,118,000**	4,831,000
Principal due within one year on long term debt		1,152,000
	18,984,000	17,192,000
LONG TERM DEBT (note 4)	**21,017,000**	9,395,000
DEFERRED INCOME TAXES	**533,000**	476,000
PREFERENCE SHARES HELD BY MINORITY SHAREHOLDERS of Maher Shoes Limited	**1,413,000**	1,413,000
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (note 5)		
Authorized		
5,250,000 Common shares without par value		
Issued		
2,875,134 Common shares (1977, 2,846,229 shares)	**7,650,000**	7,230,000
CONTRIBUTED SURPLUS		156,000
RETAINED EARNINGS	**35,993,000**	26,505,000
	43,643,000	33,891,000
	$85,590,000	$62,367,000

Long term leases (note 7)
Contingent liabilities (note 8)

Grafton Group Limited

	Year ended January 31, 1978	1977
WORKING CAPITAL DERIVED FROM		
Operations		
Income before extraordinary item	$11,012,000	$ 8,869,000
Items not involving working capital		
Depreciation	1,728,000	1,516,000
Deferred income taxes	57,000	34,000
Amortization	163,000	142,000
Equity in earnings of investments	(777,000)	(485,000)
	12,183,000	10,076,000
Sale of fixed assets	167,000	51,000
Proceeds from issue of common shares	420,000	87,000
Reclassification of investments as marketable securities	443,000	
Proceeds from sale of investments, net of income taxes	572,000	
Redemption of preference shares of Forsyth Trading Company Limited	333,000	
Decrease in mortgages receivable	40,000	8,000
Issue of long term debt, net of financing costs of $397,000	14,603,000	
	28,761,000	10,222,000
WORKING CAPITAL APPLIED TO		
Additions of fixed assets	2,782,000	2,213,000
Dividends on common shares	1,926,000	1,346,000
Reduction in non-current portion of long term debt	3,378,000	1,284,000
Purchase of 50% interest in George Richards Kingsize Clothes Limited	2,808,000	
Reclassification of marketable securities as investments		225,000
	10,894,000	5,068,000
INCREASE IN WORKING CAPITAL	17,867,000	5,154,000
WORKING CAPITAL AT BEGINNING OF YEAR	25,002,000	19,848,000
WORKING CAPITAL AT END OF YEAR	$42,869,000	$25,002,000

	1978	1977
COMPONENTS OF INCREASE IN WORKING CAPITAL		
INCREASE (DECREASE) IN CURRENT ASSETS		
Cash and bank deposit receipts	$15,098,000	$ 1,720,000
Marketable securities	2,251,000	(225,000)
Accounts receivable	1,014,000	(260,000)
Inventories	1,344,000	3,040,000
Deposits and prepaid expenses	(48,000)	(103,000)
	19,659,000	4,172,000
INCREASE (DECREASE) IN CURRENT LIABILITIES		
Accounts payable and accrued liabilities	4,657,000	(2,467,000)
Income and other taxes payable	(1,713,000)	1,535,000
Principal due within one year on long term debt	(1,152,000)	(50,000)
	1,792,000	(982,000)
INCREASE IN WORKING CAPITAL	$17,867,000	$ 5,154,000

Grafton Group Limited
Year ended January 31, 1978

1. SUMMARY OF ACCOUNTING POLICIES

(a) Principles of Consolidation

The consolidated financial statements include the accounts of all subsidiary companies since dates of acquisition. The major operating subsidiaries are as follows:

	Fiscal Year of Acquisition	Fiscal Year End
Grafton-Fraser Limited	1968	January 4, 1978
Toby Industries Limited	1970	December 31, 1977
Grafton Realty Company, Limited	1972	December 31, 1977
Maher Shoes Limited	1975	January 7, 1978

(b) Investments

The consolidated financial statements include, on an equity accounting basis, all the companies in which the company has significant influence or effective control. The operating companies accounted for on this basis are as follows:

	Fiscal Year of Acquisition	Fiscal Year End
Forsyth Trading Company Limited	1974	December 31, 1977
Barcley-Lanes Shoes	1976	January 7, 1978
George Richards Kingsize Clothes Limited	1978	December 31, 1977

(c) Inventories

The inventories are valued on the following basis:

Retail inventory—lower of cost and net realizable value less normal profit margin.

Manufacturing inventory

Raw materials—lower of cost and replacement cost.

Work in process and finished goods—lower of cost and net realizable value.

(d) Fixed Assets

Depreciation is provided as follows:

Buildings	5% diminishing balance
Equipment and fixtures	20% diminishing balance and 10% straight-line
Leaseholds	term of lease, straight-line

(e) Goodwill

Goodwill, the excess of cost over underlying book value of Maher Shoes Limited, acquired during the 1975 fiscal year, is being amortized in accordance with the requirements of the Canadian Institute of Chartered Accountants on a straight-line basis over forty years from the date of acquisition. Accumulated amortization to January 31, 1978 is $497,000.

(f) Income Taxes

The company charges earnings with income taxes currently payable and also with income taxes deferred by claiming certain costs for income tax purposes in excess of related costs charged to income. The accumulated total of such income tax deferments is reflected in the consolidated balance sheet as "Deferred income taxes".

(g) Financing Costs

Costs of issued long term debt are deferred in the year incurred and amortized against income over the term of the applicable issue.

(h) Pension Costs

Current service pension costs are charged to operations annually.

2. INVENTORIES

	1978	1977
Retail		
Apparel	$17,619,000	$16,909,000
Footwear	7,725,000	7,468,000
	25,344,000	24,377,000
Manufacturing		
Raw materials	1,291,000	1,326,000
Work in process	449,000	314,000
Finished goods	1,845,000	1,568,000
	3,585,000	3,208,000
	$28,929,000	$27,585,000

3. INVESTMENTS

	1978	1977
Forsyth Trading Company Limited		
Redeemable preference shares, at cost	$ 1,000,000	$ 1,000,000
Less redeemed	333,000	
	667,000	1,000,000
Common shares, 33⅓% interest, at equity	2,103,000	1,386,000
	2,770,000	2,386,000
George Richards Kingsize Clothes Limited		
Common shares, 50% interest, at equity	2,867,000	
Barcley-Lanes Shoes, 50% interest, at equity	228,000	227,000
Mortgages receivable	82,000	122,000
Listed marketable securities less sold or reclassified as current assets in 1978, at cost less provision for decline in value (market value 1978, $448,000; 1977, $1,872,000)	220,000	989,000
	$ 6,167,000	$ 3,724,000

On April 28, 1977 a subsidiary company, Grafton-Fraser Limited, purchased a 50% interest in George Richards Kingsize Clothes Limited at a cost of $2,808,000. George Richards Kingsize Clothes Limited is a retailer of specialty men's clothing with locations principally in Ontario. The investment is being accounted for on the equity method with the goodwill acquired of $1,911,000 being amortized to equity income over ten years on a straight-line basis. The purchase agreement contains an option whereby Grafton-Fraser Limited may purchase or may be required to purchase the remaining 50% of the shares of George Richards Kingsize Clothes Limited at a price to be determined by an agreed upon formula. This option is exerciseable five years after the date of the original purchase.

4. LONG TERM DEBT

	1978	1977
(a) 7¼% Convertible debentures, maturing June 30, 1979	**$ 5,017,000**	$ 5,036,000
(b) 10½% Sinking fund debentures, Series A, maturing June 1, 1997	**15,000,000**	
(c) 6¾% Sinking fund debentures, Series A, maturing April 1, 1987	**1,000,000**	1,100,000
(d) Term bank loan, bearing interest at the prime banking rate plus 1%, maturing September 1, 1979		3,000,000
(e) Term bank loan, bearing interest at the prime banking rate plus 1¾% (not less than 9% per annum), maturing May 1, 1982		1,411,000
	21,017,000	10,547,000
Less principal due within one year		1,152,000
	$21,017,000	$ 9,395,000

(a) The 7¼% convertible debentures of Grafton Group Limited have been issued in individual units of $50. The debentures are convertible at the holder's option into common shares of Grafton Group Limited at a conversion price of $20 per common share, and cash or scrip certificates for the balance.

The debentures may be redeemed by the company prior to June 30, 1979 if the weighted average trading price per common share, on a stock exchange, of Grafton Group is $24 or greater for each of 20 successive trading days, at which time the company may call the debentures for redemption on thirty days notice.

The debentures are secured by a first fixed and specific pledge on notes payable by Grafton-Fraser Limited to the company ($5,181,000 at January 31, 1978). These notes are secured by the pledge of 109,200 common shares of Maher Shoes Limited.

(b) During the year the company issued $15,000,000 10½% redeemable sinking fund debentures, Series A. Of the net proceeds received of approximately $14,603,000, $4,347,000 were used to prepay the term bank loans of Grafton-Fraser Limited and Grafton Realty Company, Limited. The remainder was utilized for investment and working capital purposes.

The 10½% sinking fund debentures, Series A, mature on June 1, 1997 and require sinking fund payments sufficient to retire $900,000 principal amount of the Series A debentures on June 1 in each of the years 1982 to 1996 inclusive. The company has the right, when not in default, to redeem in whole or in part the issued and outstanding Series A debentures under conditions as set out in the Trust Indenture. The company is restricted from paying cash dividends on shares if such payment exceeds consolidated net income earned after January 31, 1977 plus $7,000,000. As well, the Trust Indenture contains certain asset and earning tests which govern the issuance of additional funded obligations.

(c) The debentures of Maher Shoes Limited are secured by a first floating charge on the assets of Maher Shoes Limited. The more significant of the covenants of the trust deed restrict Maher Shoes Limited from reducing its consolidated working capital below $1,000,000 and from paying dividends on common shares if such payments would reduce consolidated working capital (which was $5,065,000 at January 7, 1978) below $1,250,000. At January 7, 1978, the company had a sinking fund credit sufficient to meet all of the $85,000 payment due in 1979 and the payments required in 1979 and future years average approximately $110,000 per annum to 1987, the date of maturity.

Principal repayments within the next five fiscal years on all long term debt of Grafton Group Limited and subsidiary companies are approximately:

	January 31, 1978	January 31, 1977
1978	**Nil**	$ 1,152,000
1979	**Nil**	1,231,000
1980	**$ 5,069,000**	6,315,000
1981	**96,000**	307,000
1982	**101,000**	337,000
1983	**1,008,000**	
	6,274,000	9,342,000
due beyond five years	**14,743,000**	1,205,000
	$21,017,000	$10,547,000

5. CAPITAL STOCK

	1978	1977
Common shares		
Issued		
Issued during the year under the Employee Stock Option Plan, 28,125 shares (1977, 3,525 shares) at $14.40	**$405,000**	$51,000
Issued under the terms of the 7¼% convertible debentures, 780 shares (1977, 1,809 shares)	**15,000**	36,000
	$420,000	$87,000

On April 28, 1977 a resolution was approved by shareholders to amend the company's Articles of Incorporation to subdivide the issued and unissued common shares without par value on a 3 for 2 basis. As a result of this amendment, the conversion price attached to the 7¼% convertible debentures has been adjusted to $20 per common share. The 1977 comparative figures have been restated to reflect this subdivision.

In addition, 250,851 common shares have been set aside for conversion privileges attached to the 7¼% convertible debentures outstanding at January 31, 1978.

6. EARNINGS PER SHARE

Earnings per share are based upon the weighted average number of shares outstanding during the year after giving effect to the 3 for 2 subdivision (2,874,354 shares in 1978 and 2,843,128 shares in 1977).

Fully diluted earnings per share illustrates the effect on earnings of the conversion of the outstanding 7¼% convertible debentures.

7. LONG TERM LEASES

Based upon all leases including licenses in existence as at their fiscal period ends, the aggregate minimum amount that will be incurred by all the company's subsidiaries as annual rental or license expense during their next five fiscal years is approximately $7,949,000.

8. CONTINGENT LIABILITIES

With respect to the investment in shares of Forsyth Trading Company Limited (note 3), Grafton Group Limited has guaranteed 50% of certain notes payable by Forsyth. Grafton Group Limited's contingent liability at January 1, 1978 amounted to $416,000 (1977, $584,000) and totally expires in August, 1980 when the above notes mature.

9. INCOME TAXES

The effective tax rate on income before income taxes was 45.1% (1977, 47.4%). This includes an inventory allowance tax deduction for income tax purposes of approximately $391,000 in 1978.

10. ANTI-INFLATION LEGISLATION

The company and its subsidiaries are subject to the Anti-Inflation Act which provides for the restraint of profit margins, prices, dividends and compensation. In management's opinion, the company and its subsidiaries have complied with the provisions of this Act for the year ended January 31, 1978.

11. OTHER STATUTORY INFORMATION

Remuneration of directors and the senior officers of the company and its subsidiaries (as defined by The Business Corporations Act) was $639,000 (1977, $612,000).

Auditors' Report

To the Shareholders of
Grafton Group Limited

We have examined the consolidated balance sheet of Grafton Group Limited as at January 31, 1978 and the consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at January 31, 1978 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Thorne Riddell & Co.
Chartered Accountants

Toronto, Canada
February 24, 1978

Grafton Group Limited

	1978	1977	1976	1975
TOTAL SALES	**169,683**	154,988	139,248	104,589
Retail Division				
Apparel				
Stores	**36,456**	32,177	28,771	21,915
Licensed Woolco Departments	**86,460**	79,762	69,971	56,931
	122,916	111,939	98,742	78,846
Footwear	**34,165**	31,553	29,359	15,285
	157,081	143,492	128,101	94,131
Homefurnishings Division	**12,602**	11,496	11,147	10,458
Cost of sales and expenses other than undernoted	**132,338**	121,903	107,981	82,810
Rentals and license expense	**14,380**	13,150	11,541	8,390
	146,718	135,053	119,522	91,200
Income from operations before the following	**22,965**	19,935	19,726	13,389
Percent to sales	**13.5**	12.9	14.2	12.8
Income from investments	**916**	580	611	341
Gain on sale of fixed assets				200
Income before taking into account the undernoted items	**23,881**	20,515	20,337	13,930
Depreciation	**1,728**	1,516	1,320	945
Interest on long term debt	**1,680**	1,018	1,144	764
Other interest	**83**	783	676	781
Amortization	**163**	142	142	71
Provision for write down of Investments				359
	3,654	3,459	3,282	2,920
Income before undernoted	**20,227**	17,056	17,055	11,010
Income taxes	**9,121**	8,093	8,427	5,763
Income before undernoted items	**11,106**	8,963	8,628	5,247
Minority interests	**94**	94	97	67
INCOME BEFORE EXTRAORDINARY ITEM	**11,012**	8,869	8,531	5,180
Extraordinary item	**246**			
NET INCOME FOR THE YEAR	**11,258**	8,869	8,531	5,180
Earnings per common share before extraordinary item –Fully Diluted	**3.58**	2.93	2.81	1.78
Dividends per common share	**.67**	.473	.40	.34
Dividend percentage of earnings	**17.1**	15.2	13.3	18.6
Weighted average number of shares outstanding	**2,874,354**	2,843,128	2,838,390	2,834,617
Effective tax rate percentage	**45.1**	47.4	49.4	52.3
Rentals as a percentage of sales	**8.6**	8.5	8.3	8.0

	January 31,					
1974	1973	1972	1971	1970	1969	1968
	Omitting $000's					
71,263	59,599	48,882	42,004	36,153	25,219	21,461
19,213	16,286	14,704	13,136	12,452	10,705	11,376
46,505	38,129	29,576	24,759	19,586	14,514	10,085
65,718	54,415	44,280	37,895	32,038	25,219	21,461
65,718	54,415	44,280	37,895	32,038	25,219	21,461
5,545	5,184	4,602	4,109	4,115		
55,798	47,708	39,790	34,396	30,482	21,630	19,155
5,984	4,943	3,951	3,353	2,468	1,769	1,447
61,782	52,651	43,741	37,749	32,950	23,399	20,602
9,481	6,948	5,141	4,255	3,203	1,820	859
13.3	11.7	10.5	10.1	8.9	7.2	4.0
				27		
9,481	6,948	5,141	4,255	3,230	1,820	859
567	393	267	196	161	100	109
172	112					
275	101	119	356	360	255	263
87						
1,101	606	386	552	521	355	372
8,380	6,342	4,755	3,703	2,709	1,465	487
4,310	3,067	2,445	2,009	1,461	789	253
4,070	3,275	2,310	1,694	1,248	676	234
36	42	51	56	218	54	47
4,034	3,233	2,259	1,638	1,030	622	187
4,034	3,233	2,259	1,638	1,030	622	187
1.43	1.15	.81	.67	.46	.39	.12
.28	.217	.133	.033			
19.6	18.9	16.4	5.0			
2,825,400	2,812,050	2,780,500	2,462,244	2,462,244	1,645,125	1,645,125
51.4	48.4	51.4	54.3	53.9	53.9	52.0
8.4	8.3	8.1	8.0	6.8	7.0	6.7

Grafton Group Limited

ASSETS	1978	1977	1976
CURRENT ASSETS			
Cash and bank deposit receipts	**25,209**	10,111	8,391
Marketable securities at lower of cost and market	**2,251**		225
Accounts receivable	**5,199**	4,185	4,445
Inventories	**28,929**	27,585	24,545
Deposits and prepaid expenses	**265**	313	416
	61,853	42,194	38,022
INVESTMENTS AND OTHER RECEIVABLES	**6,167**	3,724	3,022
FIXED ASSETS, AT COST			
Land	**1,348**	1,348	1,348
Buildings	**3,065**	3,025	2,930
Equipment, fixtures and leaseholds	**16,336**	14,739	12,902
	20,749	19,112	17,180
Less accumulated depreciation	**8,702**	7,952	6,666
	12,047	11,160	10,514
Deferred financing costs	**376**		
GOODWILL, less amortization	**5,147**	5,289	5,431
	85,590	62,367	56,989
LIABILITIES			
CURRENT LIABILITIES			
Bank advances			
Accounts payable and accrued liabilities	**15,866**	11,209	13,676
Income and other taxes payable	**3,118**	4,831	3,296
Principal due within one year on long term debt		1,152	1,202
	18,984	17,192	18,174
LONG TERM DEBT	**21,017**	9,395	10,679
DEFERRED INCOME TAXES	**533**	476	442
PREFERENCE SHARES HELD BY MINORITY SHAREHOLDERS	**1,413**	1,413	1,413
SHAREHOLDERS' EQUITY			
CAPITAL STOCK, Issued			
Preference Shares			
Common Shares	**7,650**	7,230	7,143
CONTRIBUTED SURPLUS		156	156
RETAINED EARNINGS	**35,993**	26,505	18,982
	43,643	33,891	26,281
	85,590	62,367	56,989
WORKING CAPITAL	**42,869**	25,002	19,848
Working capital ratio	**3.3:1**	2.5:1	2.1:1
Long term debt to equity ratio	**.48:1**	.28:1	.41:1
Accounts payable to inventory ratio	**.55:1**	.41:1	.56:1
Return on shareholders' equity	**25.8**	26.2	32.4
Inventory turnover – total	**5.9**	5.6	5.7
– retail	**6.2**	5.9	5.9

January 31,				
1975	1974	1973	1972	1971
Omitting $000's				
3,112	2,280	2,444	2,079	14
225	214	355	230	
4,192	3,071	2,676	2,051	1,878
23,791	11,440	8,601	6,519	5,845
238	168	282	584	100
31,558	17,173	14,358	11,463	7,837
2,447	3,016	1,013	874	797
1,348	1,390	1,390	413	
2,722	2,754	2,949	668	
11,814	4,803	3,979	3,759	3,178
15,884	8,947	8,318	4,840	3,178
5,880	3,148	2,925	2,619	1,920
10,004	5,799	5,393	2,221	1,258
5,573				
49,582	25,988	20,764	14,558	9,892
4,364				275
8,278	5,741	6,106	4,001	3,098
3,793	3,392	965	671	1,071
412	107	147	740	
16,847	9,240	7,218	5,412	4,444
11,936	1,628	1,720		190
355	79	73	41	37
1,631	479	662	788	907
				482
7,055	7,018	6,790	6,666	4,042
172	175	175	167	149
11,586	7,369	4,126	1,484	(359)
18,813	14,562	11,091	8,317	4,314
49,582	25,988	20,764	14,558	9,892
14,711	7,933	7,140	6,051	3,393
1.9:1	1.9:1	2.0:1	2.1:1	1.8:1
.63:1	.11:1	.16:1		.04:1
.35:1	.50:1	.71:1	.61:1	.53:1
27.5	27.7	29.1	27.2	38.0
4.4	6.2	6.9	7.5	7.2
4.6	6.5	7.2	7.9	7.5

Grafton Group Limited

	January 31,							
	1978	1977	1976	1975	1974	1973	1972	1971
	Omitting $000's							
QUARTERLY STATISTICS								
SALES								
1st Quarter	**28,841**	28,297	23,379	15,184	11,867	10,034	8,211	7,358
2nd Quarter	**39,407**	37,689	32,457	21,800	16,894	14,141	11,764	10,208
3rd Quarter	**40,082**	36,229	33,671	27,933	15,882	13,847	11,474	9,424
4th Quarter	**61,353**	52,773	49,741	39,672	26,621	21,577	17,433	15,014
Total	**169,683**	154,988	139,248	104,589	71,264	59,599	48,882	42,004
OPERATING INCOME								
1st Quarter	**2,259**	2,534	2,300	1,579	986	693	492	406
2nd Quarter	**3,854**	3,403	3,670	2,377	1,785	1,410	1,172	1,001
3rd Quarter	**4,613**	3,997	4,454	2,719	1,423	1,145	841	643
4th Quarter	**12,239**	10,001	9,302	6,714	5,287	3,700	2,636	2,205
Total	**22,965**	19,935	19,726	13,389	9,481	6,948	5,141	4,255
NET INCOME BEFORE EXTRAORDINARY ITEM								
1st Quarter	**766**	876	718	633	434	301	189	125
2nd Quarter	**1,685**	1,449	1,576	1,131	808	651	517	378
3rd Quarter	**1,799**	1,499	1,718	804	595	502	361	200
4th Quarter	**6,762**	5,045	4,519	2,612	2,197	1,779	1,192	935
Total	**11,012**	8,869	8,531	5,180	4,034	3,233	2,259	1,638
EARNINGS PER SHARE BEFORE EXTRAORDINARY ITEM (FULLY DILUTED)								
1st Quarter	**.26**	.30	.24	.22	.15	.11	.07	.05
2nd Quarter	**.55**	.48	.53	.40	.29	.23	.18	.13
3rd Quarter	**.59**	.50	.57	.29	.21	.18	.13	.07
4th Quarter	**2.18**	1.65	1.47	.87	.78	.63	.43	.42
Total	**3.58**	2.93	2.81	1.78	1.43	1.15	.81	.67

Calendar Year	1977	1976	1975	1974	1973	1972	1971
SEVEN YEAR RECORD OF STOCK PRICES							
High	**22.50**	24.67	21.33	18.83	28.00	28.00	13.83
Low	**15.62**	15.67	13.75	11.33	14.00	13.33	9.58

	1978	1977	1976	1975	1974	1973	1972
Market Price, January 31	**22.00**	15.67	23.11	17.33	15.00	25.00	16.33
Price earnings multiple, January 31	**6.15**	5.35	8.21	9.74	10.51	21.80	20.08
Volume of Shares traded during the year	**259,200**	170,200	283,500	345,600	290,100	450,900	694,500
Number of Shareholders	**605**	583	644	651	672	612	584
Number of Full Time Employees	**1,860**	1,800	1,775	1,750	1,000	850	775

VALUATION DAY SHARE PRICES: For capital gains purposes, some shareholders may need to know the value of their shares on Valuation Day. The December 22, 1971, Valuation Day value, as established by Revenue Canada was $13.83 for Grafton Group Limited common shares and $7.50 for Maher Shoes Limited preference shares.

Grafton Group Limited

	January 31, 1978	1977	1976	1975	1974	1973	1972	1971	1970	1969	1968
NUMBER OF BRANCHES											
Apparel Division											
Leased Woolco Departments	**93**	86	79	72	67	56	47	41	33	27	22
Company Stores	**89**	80	79	72	65	54	51	46	41	39	40
Total	**182**	166	158	144	132	110	98	87	74	66	62
Footwear Division	**176**	196	203	217							
BRANCHES OPENED											
Apparel Division	**20**	15	16	15	24	16	13	14	10	6	5
Footwear Division	**15**	3	14	24							
BRANCHES CLOSED OR COMBINED											
Apparel Division	**4**	7	2	3	2	4	2	1	2	2	1
Footwear Division – Closed	**15**	10	28	17							
– Combined	**20**										
STORE SPACE AT END OF YEAR, omitting 000's											
Apparel Division	**1,134**	1,070	1,005	912	850	718	633	579	488	424	377
Footwear Division	**353**	351	364	398							
SALES PER SQUARE FOOT based on year end space											
Apparel Division											
Leased Woolco Departments	**$112.6**	$109.1	$103.8	$92.7	$81.6	$80.6	$73.4	$70.7	$69.2	$62.3	$53.1
Company Stores	**$ 99.6**	$ 94.9	$ 86.9	$73.5	$68.6	$66.5	$63.9	$57.4	$60.7	$56.1	$60.8
Total Apparel	**$108.4**	$104.5	$ 98.2	$86.5	$77.3	$75.8	$69.9	$65.4	$65.6	$59.5	$56.9
Footwear Division	**$ 96.8**	$ 88.7	$ 79.6	$67.8							

SALES BY REGION

	APPAREL DIVISION								FOOTWEAR DIVISION			
	Leased Woolco Depts.				Company Stores							
	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales	Number of Branches	Percent of Division Sales
	1978		1977		1978		1977		1978		1977	
British Columbia	5	5.1	5	4.9	12	9.9	10	9.5	41	20.5	40	20.4
Alberta	9	14.3	9	15.1	7	9.3	5	7.2	6	2.8	5	2.4
Saskatchewan and Manitoba	11	13.3	10	12.6	6	6.4	5	5.7	4	1.5	3	1.2
Ontario	35	36.3	31	36.3	54	66.8	52	71.2	106	65.2	130	66.4
Quebec	25	20.5	24	21.0	1	.8	1	1.0	7	4.7	6	4.3
Maritimes	8	10.5	7	10.1	9	6.8	7	5.4	12	5.3	12	5.3
Total	93	100.0	86	100.0	89	100.0	80	100.0	176	100.0	196	100.0

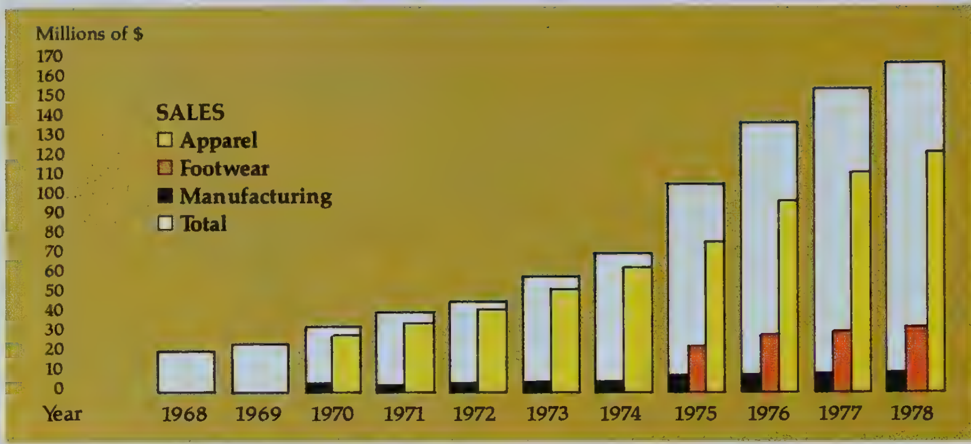
A specific list of store locations is available on request.

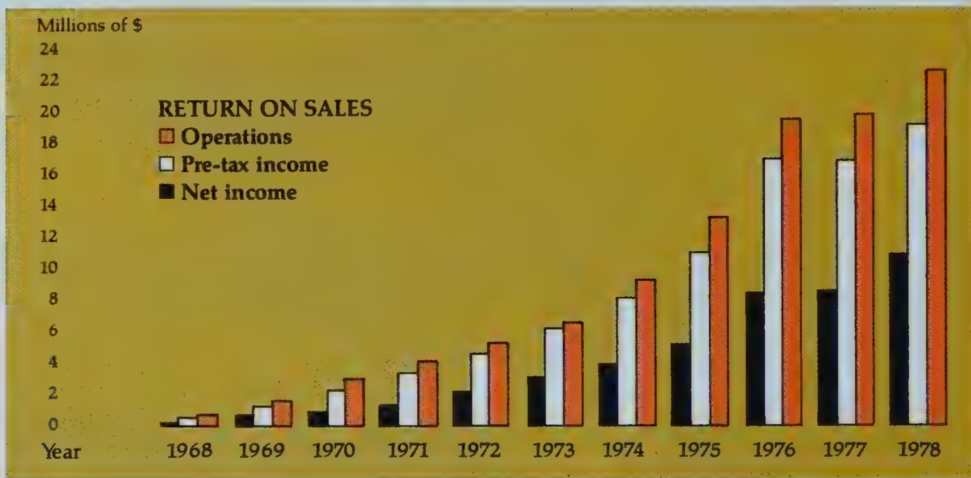
1. Sales–The sales graph, by divisions, shows that one year, 5 year and 10 year compound growth rates are 9%, 23% and 23%.

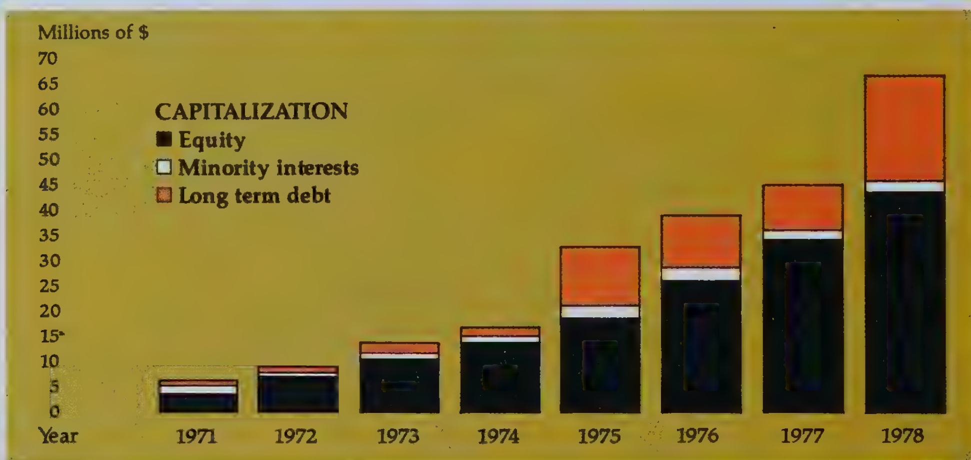
2. Operating, Pre-Income Tax and Net Income–The one year, 5 year and 10 year compound increase in net income are 24%, 28% and 58% respectively.

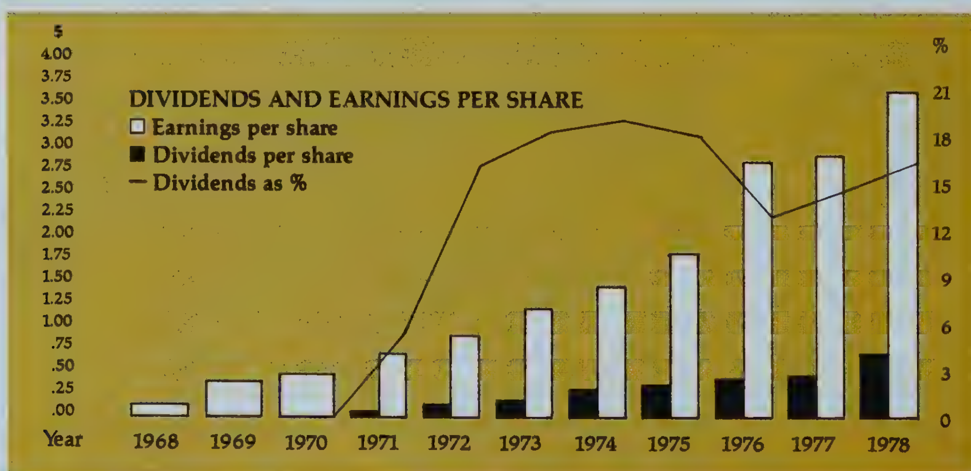
3. Capitalization–The graph illustrates that the major source of company funds is being generated by rapidly increasing Shareholders' Equity and that long term debt has increased to a lesser extent over the past five years.

4. Dividends and Earnings Per Share–The graph indicates that the dividends paid per share are at a very modest level and are being inhibited by the present Anti-Inflation Act from rising to the Company's pre A.I.B. level.









CHARLES A. CADIEUX, C.M., K.G.C.H.S., *Retired Retail Executive*	*Toronto, Ontario*
*G. RICHARD CHATER, *President, the Company*	*Campbellville, Ontario*
BRIG.-GEN. W. PRESTON GILBRIDE, C.B.E., D.S.O., E.D., LL.D. *Chairman, the Company*	*Toronto, Ontario*
WILLIAM A. HEASLIP, *Executive Vice President, the Company*	*Milton, Ontario*
WILLIAM F. JAMES, PH.D., *Consulting Geologist*	*Toronto, Ontario*
*JAMES W. McCUTCHEON, Q.C., *Partner, Shibley, Righton & McCutcheon*	*Toronto, Ontario*
STEWART PHILP, *Retired President of a Subsidiary*	*Hamilton, Ontario*
*JOHN B. RIDLEY, C.M., *Retired Investment Dealer*	*Toronto, Ontario*
SAM FOSTER ROSS, Q.C., *Partner, Ross & McBride*	*Dundas, Ontario*
*GEORGE A. REYNOLDS, C.A., *Vice President Finance, Secretary and Treasurer, the Company*	*Thornhill, Ontario*
T. EDWARD TOPPING, *President, Grafton-Fraser Limited*	*Stouffville, Ontario*
*DAVID B. WELDON, *Chairman of the Board, Midland Doherty Limited*	*Toronto, Ontario*
DOUGLAS C. WOOLLEY, Q.C., *Partner, Woolley, Dale & Dingwall*	*Toronto, Ontario*
THOMAS R. YOUNG, *President, Toby Industries Limited*	*Goodwood, Ontario*

**Audit Committee*

CORPORATE AFFILIATION OF DIRECTORS

Mr. Cadieux *is a Director and retired Executive Vice President–F. W. Woolworth Co. Limited and a Director of Guaranty Trust Company of Canada.*

Mr. Chater *is a Director of Canadian General Securities, Limited, Guaranty Trust Company of Canada, Traders Group Limited and its Insurance Subsidiaries.*

Mr. Gilbride *is a Director of Carling O'Keefe Limited, Guaranty Trust Company of Canada and Traders Group Limited.*

Mr. Heaslip *is a Director of Canadian General Securities, Limited.*

Dr. James *is a Director of Alminex Limited, Bayer Foreign Investment Limited, Campbell Red Lake Mines Limited, Dome Mines Limited, Falconbridge Dominicana C. por A., Falconbridge Nickel Mines Limited, Giant Yellowknife Mines Limited, Granby Mining Corporation, Granisle Copper Limited, Irish Base Metals Limited, Lolor Mines Limited, Northgate Exploration Limited, Templeton Growth Fund of Canada Limited and Director Emeritus of the Canadian Imperial Bank of Commerce.*

Mr. McCutcheon *is a Director of Biltmore Industries Limited, Canadian General Securities, Limited, Guaranty Trust Company of Canada, Kerr Addison Mines Limited, Traders Group Limited and its Insurance Subsidiaries.*

Mr. Philp *is a Director of Equitrust Mortgage and Savings Company (formerly Fidelity Mortgage and Savings Corporation).*

Mr. Ridley *is a retired Executive Vice President and Managing Director of A. E. Ames & Co. Limited.*

Mr. Ross *is President and Director of Equitrust Mortgage and Savings Company (formerly Fidelity Mortgage and Savings Corporation).*

Mr. Reynolds *is Secretary of Canadian General Securities, Limited.*

Mr. Topping *is a Director of the Retail Council of Canada.*

Mr. Weldon *is Vice President and Director of The Goderich Elevator and Transit Company Limited and a Director of Biltmore Industries Limited, Commonwealth Holiday Inns of Canada Limited, Emco Limited, Guaranty Trust Company of Canada and Silverwood Industries Limited.*

Maher. Canada's foremost family footwear retailer.

A Loft fashion window.

George Richards. Big men, tall men, fashion leaders.

Decorative home furnishings by Toby.

GRAFTON GROUP LIMITED
W. P. Gilbride, *Chairman*
G. R. Chater, *President*
W. A. Heaslip, *Executive Vice President*
G. A. Reynolds, C.A., *Vice President, Finance, Secretary and Treasurer*

GRAFTON-FRASER LIMITED
G. R. Chater, *Chairman and Chief Executive Officer*
T. E. Topping, *President*
J. B. Coutts, *Senior Vice President*
A. L. Lucas, *Senior Vice President*
G. A. Reynolds, C.A., *Senior Vice President and Secretary*
E. C. Frederick, *Vice President*
J. R. Walker, *Vice President*
S. A. Lindsay, C.A., *Vice President and Treasurer*
W. J. Smith, *Vice President*
B. A. Renihan, C.A., *Controller*
H. Sanders, *Public Relations Administrator*

MAHER SHOES LIMITED
T. P. Wilson, *President*
J. W. Reid, *President of a Subsidiary*
R. C. Wilson, *Senior Vice President*
J. R. Gillies, C.A., *Vice President and Treasurer*
D. F. Gerrish, C.A., *Controller*
G. F. Travelle, *Distribution Co-ordinator*

TOBY INDUSTRIES LIMITED
T. R. Young, *President*
D. P. Worsnop, C.A., *Controller*

GRAFTON REALTY COMPANY, LIMITED
W. A. Heaslip, *President*
Mrs. J. A. Lawson, *Assistant Secretary*

TRANSFER AGENTS AND REGISTRARS
Grafton Group Limited
7¼% Convertible Debentures
The Canada Trust Company
10½% Sinking Fund Debentures, Series A
The Royal Trust Company
Common Shares
Guaranty Trust Company of Canada
Maher Shoes Limited
6¾% Sinking Fund Debentures, Series A
Canada Permanent Trust Company
Preference Shares
The Canada Trust Company

AUDITORS
Thorne Riddell & Co., Toronto

BANKERS
Canadian Imperial Bank of Commerce, Toronto
Bank of Nova Scotia, Toronto

STOCK EXCHANGE LISTINGS
Grafton Group Limited Common Shares
Toronto Stock Exchange
Montreal Stock Exchange
Maher Shoes Limited Preference Shares
Toronto Stock Exchange

Grafton Group Limited